Maricopa County

Office of Management and Budget

301 West Jefferson Street
Suite 1070
Phoenix, AZ 85003-2143
Phone: 602-506-7280
Fax: 602-506-3063
www.maricopa.gov

Management Report: Maricopa Integrated Health System Fund Balances and Impact on the General Fund

June 2002

Christopher Bradley, Budget Manager

Introduction

As the books were being closed for FY 2000-01, Internal Audit began to express concerns about the cash position of Maricopa Medical Center and the Maricopa Integrated Health System (MIHS) as a whole. The primary concern has been to insure that current financial trends in the health system do not adversely affect the General Fund, and to insure that the situation is presented in a manner that provides greater transparency for County policy makers.

In response to these concerns, the Office of Management and Budget (OMB) engaged an outside firm to develop financial forecasts for the health system and to review the system's revenue cycle. OMB and the Department of Finance have also reviewed how MIHS financial information is presented for budgetary purposes and in financial statements. This process has focused on developing a more consistent and accurate measure of MIHS cash balances, as well as the appropriate treatment of "fund balance" for budgetary purposes. The following discussion primarily focuses on the results of this process as they relate to County budgetary decisions.

Unreserved Fund Equity vs. "Expendable Fund Balance"

For budgeting purposes, estimated beginning fund balances need to reflect resources that are available and can be expended. For governmental funds (the General Fund, as well as special revenue, debt service, and capital project funds) "Unreserved Fund Balance" as presented in audited financial statements meets this definition. Unreserved fund balance for governmental funds excludes non-expendable assets (net property plant, and equipment) as well as long term debt liabilities that will not be repaid in the current year.

For proprietary funds (enterprise and internal service funds), "Unreserved Fund Equity" as reported in audited financial statements reflects both net property, plant and equipment as well as long-term liabilities. As a result, "Unreserved Fund Equity" does not represent expendable fund balance for

budgetary purposes. Expendable fund balance must therefore be calculated based on current assets (adjusted for any amounts that must be held to meet contractual obligations) and current liabilities.
The formula for calculating expendable fund balance is as follows:

Expendable Fund Balance = current assets – cash held for contractual obligations – current liabilities

If a particular fund incurs a deficit expendable fund balance, that fund by definition does not have enough liquid assets to support its ongoing operations. There are two options to address such a situation:

1. The fund can borrow cash from other funds on a short-term basis.

2. A fund transfer from another fund that has a positive expendable fund balance can increase the fund's expendable fund balance.

The first option is appropriate if it is reasonably anticipated that the deficit will be recovered within a short period of time, and if there is a valid plan to do so. If, however, the deficit expendable fund balance is due to an operating loss that will not likely be recovered, the second option is appropriate.

In the event that a deficit expendable fund balance is not likely to be recovered and cash is merely borrowed from another fund, the expendable fund balance of the lending fund is thereby overstated. This creates the risk that expenditure commitments could be made against the lending fund's supposed expendable fund balance when in fact there are not sufficient resources to support such commitments. The General Fund is not legally restricted, and therefore is by default the presumed source for covering deficits in other funds. In an extreme situation, deficit expendable fund balances in enterprise and internal service funds could accumulate to the point where they exhaust the resources of the County as a whole and drive it into default.

The relationship between the Maricopa Medical Center enterprise fund and the General Fund is a significant example of cash borrowing between funds. The FY 2000-01 *Comprehensive Annual Financial Report* shows the Maricopa Medical Center with "Cash and Investments Held by County Treasurer" at zero under current assets, but with $76,228,477 listed under current liabilities as "Due to Other Funds". The "Due to Other Funds" represented the fact that in effect Maricopa Medical Center had to "borrow" cash from the General Fund. This situation was acceptable given two assumptions: 1) that the $49,709,415 reported as "Receivable (Net of Allowance for Uncollectibles) was valid and would be converted to cash within a reasonably short period, and; 2) that accumulated resources in the ALTCS and Non-AHCCCS Plans funds covered the remaining shortfall.

MIHS Unreserved Fund Equity vs. Expendable Fund Balances

The "Maricopa Integrated Health System" includes six separate enterprise funds, the Maricopa Medical Center along with four separate managed care plans and an administration fund. From a management and policy perspective, these six funds have been treated as a consolidated unit, in which a deficit in one fund is covered by the favorable balances in the other funds. The following table compares Unreserved Fund Equity for each fund as reported in the FY 2000-01 Comprehensive Annual Financial Report to "Expendable Fund Balance":

	Unreserved Fund Equity at June 30, 2001	Net Expendable Fund Balance at June 30, 2001	FY 2001-02 Internal Fund Transfers	Expendable Fund Balance after Transfers
MEDICAL CENTER	$(33,969,555)	$ (48,727,473)	$ 37,852,704	$ (10,874,769)
MARICOPA HEALTH PLAN	21,438,027	16,633,344	(16,633,344)	-
ALTCS	45,384,229	27,139,946	(27,139,946)	-
HEALTH SELECT	1,869,565	1,869,565	0	1,869,565
SENIOR SELECT	(5,929,992)	(5,920,586)	5,920,586	-
MANAGED CARE ADMINISTRAT	-	(2,996)	0	(2,996)
Net Totals	$ 28,792,274	$ (9,008,200)	$ -	$ (9,008,200)

As shown above, the combined Unreserved Fund Equity for the MIHS enterprise funds was *favorable* at the close of last fiscal year, but the combined Net Expendable Fund Balance reflects a net *deficit*. Furthermore, between the close of FY 1999-00 and FY 2000-01, combined Unreserved Fund Equity for the MIHS funds increased by over $4.6 million, while Net Expendable Fund Balance decreased by nearly $22.6 million, moving from an overall positive to a negative position.

Unreserved Fund Equity:

	June 30, 2000	June 30, 2001	Variance
MEDICAL CENTER	$(34,434,235)	$ (33,969,555)	$ 464,680
MARICOPA HEALTH PLAN	16,976,818	21,438,027	4,461,209
ALTCS	44,773,547	45,384,229	610,682
HEALTH SELECT	412,966	1,869,565	1,456,599
SENIOR SELECT	(3,566,182)	(5,929,992)	(2,363,810)
MANAGED CARE ADMINISTRAT	-	-	-
Net Totals	$ 24,162,914	$ 28,792,274	$ 4,629,360

Net Expendable Fund Balance:

	June 30, 2000	June 30, 2001	Variance
MEDICAL CENTER	$(20,619,926)	$ (48,727,473)	$ (28,107,547)
MARICOPA HEALTH PLAN	12,128,401	16,633,344	4,504,943
ALTCS	25,157,563	27,139,946	1,982,383
HEALTH SELECT	412,966	1,869,565	1,456,599
SENIOR SELECT	(3,557,216)	(5,920,586)	(2,363,370)
MANAGED CARE ADMINISTRAT	-	(2,996)	(2,996)
Net Totals	$ 13,521,788	$ (9,008,200)	$ (22,529,988)

Based on Net Expendable Fund Balance, even if all available resources in the ALTCS and Maricopa Health Plan funds had been transferred to cover the deficits in the Medical Center and Non-AHCCCS Health Plans funds, a combined deficit balance of $9.0 million would have remained. A transfer from the General Fund should have eliminated this $9.0 million deficit. If this had been done, the cash borrowed by the Medical Center fund from the General Fund would have been reduced to an amount consistent with the Medical Center fund's accounts receivable at that point. The General Fund's ending unreserved balance would also have been reduced.

One problem with the above scenario is the timing of the transfer of the balances from the plan funds to the Medical Center fund, given the requirements of the County's contracts with AHCCCS. The contracts require AHCCCS approval of such fund transfers, and only based on audited financial statements. As a result, net profits from the two plans for FY 2000-01 could only be transferred to the Medical Center and Senior Select funds after the close of the fiscal year, in FY 2001-02. This situation could have been handled in two ways:

1. Only the $9.0 million could have been transferred from the General Fund at the close of the fiscal year, the net deficit Expendable Fund Balances in the Medical Center and Non-AHCCCS Health Plans funds could have been carried forward. The deficits would be covered by borrowing cash from the General Fund, reflected as a "due to other funds" in the financial statements. The basis for the validity of the "due to" would have been the Medical Center fund's receivables and the assumption that the funds from the plans would have been transferred as soon as possible in FY 2001-02, and for an established amount. A similar situation would then occur at the end of FY 2001-02 and each year thereafter.

2. The total combined deficit of $52.8 million in the Medical Center, Health Select and Senior Select funds could have been covered by a transfer from the General Fund, leaving a lower "due to" amount consistent with the Medical Center's receivables. The FY 2000-01 plan net income would then carry forward to cover losses in the Medical Center and Non-

AHCCCS Health Plans funds for FY 2001-02, rolling forward each year thereafter. Handling the issue in this manner would also have allowed the Medical Center and Senior Select funds to earn interest income that otherwise would have been allocated to the General Fund

Impact of MMC increase in Accounts Receivable

The following table shows the changes in MIHS accounts receivable from the end of FY 1999-00 to the end of FY 2000-01, and year-to-date through March 31 for this fiscal year. Receivable balances grew in several MIHS funds, most significantly in the Medical Center. While much of the FY 2001-02 increase ($14 million) is explained by a change in the contractual relationship with Value Options, a large portion of the increase is due to problems in the Medical Center's revenue collection process. This issue has been more fully discussed in the consultant's revenue cycle analysis.

Accounts Receivable:

	June 30, 2000	June 30, 2001	Variance	March 31, 2002	Variance
MEDICAL CENTER	$ 28,405,380	$ 52,127,753	$(23,722,373)	$ 64,095,187	$ (11,967,434)
MARICOPA HEALTH PLAN	2,374,930	6,187,827	(3,812,897)	6,486,317	(298,490)
ALTCS	2,491,689	6,923,558	(4,431,869)	5,944,879	978,679
HEALTH SELECT	18,717	53,917	(35,200)	99,991	(46,074)
SENIOR SELECT	205,786	3	205,783	56,803	(56,800)
MANAGED CARE ADMINISTRATION	1,315	-	1,315	389	(389)
Net Totals	$ 33,497,817	$ 65,293,058	$(31,795,241)	$ 76,683,566	$ (11,390,508)

For purposes of this discussion, the important factor is the potential impact on the County General Fund. If a significant portion of the Medical Center's accounts receivable prove to be uncollectable, they will have to be written off. A large write-off would negatively affect MIHS' net income for the current period, as well as reduce both unreserved fund equity and expendable fund balance. The formula for calculating expendable fund balance includes accounts receivable as a current asset on the assumption that amounts owed will be repaid within a relatively short period. As shown in the preceding analysis of MIHS expendable fund balance, a significant write-off of accounts receivable could not be absorbed by the health care system without an additional General Fund subsidy.

Given the threat of a negative impact to the General Fund of an MIHS write-off of accounts receivable, the following two steps should be taken:

1. The value of the accounts receivable should be assessed immediately, building on work already completed to date by the consultant.
2. An amount should be designated within the General Fund Unreserved Balance to cover a potential write-off of MIHS accounts receivable.

Based on information provided by the consultants following their revenue cycle analysis, as much as $13 million may need to be designated within the General Fund. This amount represents particularly aged accounts that will require significant management efforts to recover, even in part. MIHS management is confident that their accounts receivable is fully reserved and that a write-off will not be necessary. However, reserving funds and having an independent auditor value the accounts receivable is the most prudent and conservative approach.

MIHS Capital Outlay

As noted previously, the drop in expendable fund balance vs. unreserved fund equity was due to large expenditures on capital outlay supported by the system's cash reserves. The overall increases in net property, plant and equipment are shown in the following table:

Net Property, Plant & Equipment:

	June 30, 2000	June 30, 2001	Variance	March 31, 2002	Variance
MEDICAL CENTER	$ 68,343,333	$ 101,315,228	$ 32,971,895	$ 113,410,588	$ 12,095,360
MARICOPA HEALTH PLAN	65,046	21,312	(43,734)	10,962	(10,350)
ALTCS	254,448	1,129,097	874,649	1,940,045	810,948
HEALTH SELECT	-	-	-	-	-
SENIOR SELECT	435	(5)	(440)	-	5
MANAGED CARE ADMINISTRATION	-	2,996	2,996	2,996	-
Net Totals	$ 68,663,262	$ 102,468,628	$ 33,805,366	$ 115,364,591	$ 12,895,963

MIHS spent a total of $41.2 million on capital outlay in FY 2000-01, of which $15.8 million was funded by Certificates of Participation (COP's) and $25.4 million funded by cash. The capital expenditures from cash did not affect MIHS income statements except to the extent that they resulted in higher depreciation expense, but did entail a reduction in cash on the balance sheets. Based on the expendable fund balance analysis for FY 2000-01, which showed an ending deficit of $9.0 million, in effect there was not enough cash in the MIHS funds to support all of the capital expenditures. The result was that MIHS "borrowed" the $9.0 million from the General Fund to support its capital outlay, without Board approval.

It is interesting to note the types of items that are reported by MIHS as capital outlay vs. operating expenses. For all other Maricopa County funds, capital outlay is defined as spending on items that cost $5,000 or more per unit and have a useful life of at least one year. A cursory review of an itemized listing of MIHS FY 2000-01 capital outlay reveals many items, such as personal computers, that cost less than $5,000 per item and would therefore not meet the County's standard definition for capital outlay. If MIHS had followed the County's definition, reported net income and unreserved fund equity would have been lower, and more in line with expendable fund balance. In the long run, depreciation expense would also be lower. The difference in capital outlay definitions will be discussed with MIHS management, and a change in reporting practices may be recommended.

MIHS' reporting practices in regard to capital outlay should be reviewed and adjusted if necessary. For purposes of budget review and monitoring at the County level, MIHS budgets should reflect capital outlay rather than depreciation expense in order to present a more realistic picture of projected impacts on expendable fund balance.

Recommendations

1. Expendable Fund Balance should be used for purposes of MIHS budget review and monitoring at the County level. In addition, MIHS budgets at the County level should be presented with capital outlay rather than depreciation expense in order to more accurately project changes in expendable fund balance.

2. MIHS should immediately seek approval from AHCCCS to transfer FY 2000-01 ending net expendable fund balances from the ALTCS and Maricopa Health Plan funds to the Medical Center and Senior Select funds before the close of the current fiscal year.

3. An amount equal to the remaining FY 2000-01 expendable fund deficit of $9.0 million should be transferred from the General Fund to the Medical Center and/or Senior Select funds before the close of the fiscal year. In addition, Board approval should be sought to transfer an additional amount not to exceed $5 million from the General Fund to cover the projected FY 2001-02 ending expendable fund deficit after the $9.0 million subsidy. When these transfers are completed, the FY 2001-02 *Comprehensive Annual Financial Report* balance sheet for the Medical Center should reflect zero cash and a "due to" the General Fund roughly equal to the ending expendable fund balances in the ALTCS and Maricopa Health Plan funds plus the accounts receivable balance.

4. MIHS accounts receivable should be immediately reviewed, and, if necessary, written down to a more realistic level. An additional General Fund subsidy may be necessary. Within the General Fund estimated beginning balance for FY 2002-03, $13 million should be designated to cover a worst-case write-off scenario.

5. An additional General Fund subsidy should be budgeted depending on the size of the operating loss, if any, in the final adopted FY 2002-03 budget for MIHS. An additional amount should be designated within the General Fund beginning balance for FY 2002-03 to cover potential worst-case MIHS operating losses of up to $40 million.